BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
SUSAN BITTER SMITH, Chairman
BOB STUMP
BOB BURNS
DOUG LITTLE
TOM FORESE

IN THE MATTER OF THE APPLICATION OF GLOBAL WATER – SANTA CRUZ WATER COMPANY, INC. FOR AN EXTENSION OF ITS EXISTING CERTIFICATE OF CONVENIENCE AND NECESSITY	DOCKET NO. W-20446A-14-0290 **NOTICE OF ERRATA**

Global Water – Santa Cruz Water Company ("Company") provides this Notice of Errata regarding the Response to Staff Report filed by the Company on May 19, 2015. The Company's response inadvertently omitted page 3. A complete copy of the Response, including page 3 is attached as Exhibit A to this Notice. The Company regrets the error.

RESPECTFULLY SUBMITTED this 2nd day of June 2015.

SNELL & WILMER L.L.P.

By [signature]
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By Jaclyn Howard

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Exhibit A

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IN THE MATTER OF THE APPLICATION OF GLOBAL WATER – SANTA CRUZ WATER COMPANY, INC. FOR AN EXTENSION OF ITS EXISTING CERTIFICATE OF CONVENIENCE AND NECESSITY	DOCKET NO. W-20446A-14-0290 **RESPONSE TO STAFF REPORT**

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Global Water – Santa Cruz Water Company ("Santa Cruz") provides this response to the Staff Report in this docket. Santa Cruz appreciates Staff's recommendation to approve the extension of its CC&N to serve the Estrella Gin parcel, which is adjacent to Santa Cruz's existing certificated area. The Estrella Gin parcel is owned by the City of Maricopa, and it is a high priority commercial development project for the City. Santa Cruz looks forward to extending service to this parcel, and to continuing to provide the City and its residents and commercial establishments with high quality potable water service.

Santa Cruz has one concern with the Staff Report. The Staff Report contains the following proposed condition, "The Company should be placed on notice that, to the extent possible, it should plan to fund infrastructure needs with equity and long term debt in order to bring more balance to its infrastructure."[1] Santa Cruz respectfully disagrees with this proposed condition. This proposed condition was based on Staff's concerns about Santa Cruz's capital structure. Santa Cruz agrees with Staff that "[a] utility's capital structure is an indicator of financial soundness." [2] Santa Cruz also agrees with

[1] Staff Report, page 4, recommendation no. 2.
[2] Staff Report, Exhibit 3 (Staff Financial Report) at page 3.

Staff that an excessive amount of advances and contributions in a utility's capital structure can be problematic. Indeed, this is a point Santa Cruz and its affiliates have made on many occasions in the past. So Staff and Santa Cruz are on common ground about the desirability of a balanced capital structure and about the dangers of excessive advances and contributions.

The area of disagreement is essentially, "how much is too much" in terms of advances and contributions. The Staff Report states "Staff has determined that a financially sound utility company, on average, should have no more than 30 percent AIAC and/or CIAC in its capital structure."[3] Staff calculates that advances and contributions were 35.29% of Santa Cruz's capital structure at the end of 2014, or 35.57% on a pro-forma basis considering the effect of the CC&N extension.[4] In other words, Santa Cruz has only 5% more than Staff recommends. Further, Staff has no specific "study, report or analysis" supporting its specific 30 percent figure.[5]

Santa Cruz believes that 35% is not an excessive amount of advances and contributions. Advances and contributions have significant advantages and disadvantages. The biggest advantage is providing a low cost source of capital, benefiting ratepayers, as well as limiting the amount of debt and equity the utility must raise. But this is also the biggest disadvantage, because advances and contributions are excluded from rate base. Thus, excessive advances and contributions can leave a utility with too little rate base, and therefore result in rates that are too low for financial viability.

This is not a concern with Santa Cruz. Santa Cruz has over $59 million in equity, which is over 62% of its capital structure.[6] It is not thinly capitalized. Further, as Staff acknowledges, Santa Cruz has over $5.5 million in positive cash flow, including approximately $2.3 million in net income. Specifically, "Staff found that Santa Cruz had

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[3] Staff Report, Exhibit 3(Staff Financial Report) at page 3.
[4] Staff Response to Global Data Request 1.02 (work papers), file "Capital Structure – Santa Cruz CCN 13-0290.xls, tab "Schedule TBH-1".
[5] Staff Response to Global Data Request 1.03.
[6] Staff Response to Global Data Request 1.02 (work papers), file "Capital Structure – Santa Cruz CCN 13-0290.xls, tab "Schedule TBH-1", line 18, column A. Figure is for the year ending December 31, 2014.

a positive cash flow of $5,586,083 during this financial reporting period (i.e., $2,251,427 net operating income not inclusive of income taxes + $3,334,656 in depreciation expense net of CIAC amortization) which is sufficient to fund Santa Cruz's operational needs and to provide water service in the requested CC&N service area."[7] Further, under Decision No. 74364 (Feb. 26, 2014), Santa Cruz's rates are being phased in over eight years, with the first increase taking effect January 1, 2015. Thus, Santa Cruz's 2014 net income did not include the effect of the rate increase, and Santa Cruz's net income should improve as the phase-in occurs though January 1, 2021.

Further, Santa Cruz is not entirely in control of its capital structure. For example, Santa Cruz is obligated to collect hook-up fees under Decision No. 74364, as it agreed in the Settlement Agreement in that docket. The Settlement Agreement requires that "[a]ll future capital requirements will be met with debt, equity, hook-up fees, or through main extension agreements."[8] In addition, the rate decision required Santa Cruz, the other Global Utilities, and Staff to develop a Code of Conduct. The Code of Conduct includes two relevant provisions:

- The Global Utilities will continue to use main extension agreements in accordance with Commission rules. Any associated funds or infrastructure (or land associated with the infrastructure which is conveyed to Global) used to provide water or wastewater will be segregated to or owned by the Global Utilities.[9]
- The continuous goal of improving the long-term financial health of the Global Utilities.[10]

Thus, Santa Cruz is required to collect hook-up fees (generating contributions) and to continue to use main extension agreements (generating advances). Adding additional

[7] Staff Report, Exhibit 3 (Financial Report) at page 2.
[8] Decision No. 74364 (Feb. 26, 2014), Attachment A (Settlement Agreement) at Section 6.1.2.
[9] Code of Conduct filed on August 15, 2015, at § IV.B.5.
[10] Code of Conduct filed on August 15, 2015, at § IV.F.5, paragraph 2.

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requirements limiting management's discretion regarding capital structure is not necessary.

Further, Staff's 30% figure has not been approved in a rule, and applying it a rigid manner risks violating the Arizona Administrative Procedure Act ("APA"). The recent Arizona Court of Appeals opinion in *Arizona State University ex rel. Arizona Board of Regents v. Arizona State Retirement System*[11] clarifies that under the APA, "an agency statement is a rule, subject to the APA's rulemaking procedure, if it, first, is generally applicable, and, second, implements, interprets or prescribes law or policy, or describes the procedure or practice requirements of an agency."[12] Thus, if the Commission imposes conditions on all utilities if they do not meet the 30% standard, it would be a statement of "general applicability" that "implements, interprets or prescribes… policy"[13], and such a practice would therefore be an invalid rule. This problem can be avoided by not using 30% as a fixed standard, and instead looking holistically at each utility's capital structure.

In summary, Santa Cruz shares Staff's belief in the importance of a balanced capital structure and concern with excessive advances and contributions. Here, Santa Cruz has a reasonable capital structure, with advances and contributions making up only 35% of its capital structure, and with equity exceeding 62%. Santa Cruz already has Commission requirements for hook-up fees and main extension agreements, and Santa Cruz needs some flexibility in determining the appropriate method of financing any particular project. Thus, Santa Cruz requests that this condition not be adopted. As a compromise, the following requirement from the rate case could be added as a condition, "all future capital requirements will be met with debt, equity, hook-up fees, or through main extension agreements." Santa Cruz appreciates the Commission's consideration of this matter.

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[11] No. 1 CA-CV 14-0083, filed May 5, 2015. 2015 WL 2328733. Not yet published in Arizona Reports or Arizona Advanced Reports.
[12] *Id.* at ¶ 16.
[13] *Id.* at ¶ 15, quoting A.R.S. § 41-1001(19).

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RESPECTFULLY SUBMITTED this 19th day of May 2015.

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